



Rural Telephone Coalition

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JAN 29 1997

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of)	
)	
Access Charge Reform)	CC DOC 96-262
)	
Price Cap Performance Review for Local Exchange Carriers)	CC Docket No. 94-1
)	
Transport Rate Structure and Pricing)	CC Docket No. 91-213
)	
Usage of the Public Switched Network by Information Service and Internet Access Providers)	CC Docket No. 96-263
)	

COMMENTS

of the

RURAL TELEPHONE COALITION

January 29, 1997

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SUMMARY

For small LECs, access reform is as important as it is to price cap companies. Principles underlying rules established for price cap LECs must be consistent with principles underlying rules for small LECs. The Commission should return to the “carrier initiated rates” methodology. The LECs are in the best position to design their own rate structures that reflect their own circumstances. This change would not require the Commission to give up its authority to set rate levels.

RTC agrees with the Commission that flat rate carrier common line charges to IXC make economic sense. NTS costs associated with the CCL charge should not be recovered on a traffic sensitive basis. Although the RTC supports a flat rate charge, it believes the most efficient way to recover these costs is by bulk billing the IXCs that are the cost causers. Increase of the SLC on second lines is an unwise choice as it defeats the universal service goals of the Act. A great proportion of rural companies’ switching costs are nontraffic sensitive. The Commission should recognize this fact in the course of its examination of NTS costs associated with switching.

As the revenue streams associated with the TIC are vitally important to rural companies, the RTC urges the Commission to base its revised rules on data that adequately reflect the costs associated with rural company provision of transport. The RTC believes that transport costs can be made explicit and bulk billed to the IXCs. Whatever recovery the Commission devises should take account of the higher costs of providing transport in low density rural areas.

The Commission should resolve its terminating access charge concerns the same way for incumbent LECs and CLECs because the differences between originating and terminating access, such as whose customer chooses the local distribution carrier, are the same for both types of LECs. Reluctance to impose regulation on competitive entrants and eagerness to retain regulation for incumbents are not legally sufficient reasons for treating similarly-circumstanced LECs disparately. The chosen approach should employ minimal regulation, but should not (a) transfer all recovery for terminating access to the originating caller without adopting universal service mechanisms that will maintain interexchange rate averaging and rural long distance competition incentives, or (b) discourage call acceptance by charging the called party.

Another measure necessary to prevent interexchange carriers from absorbing any access charge reductions in profits is a requirement to pass such reductions through proportionately to interexchange carriers' end users. The marketplace evidence related to interexchange price changes indicates that interexchange competition has not yet driven prices to each carrier's forward looking costs. Moreover, the Commission should not forbear from enforcing the recently adopted statutory requirement for interexchange rate averaging to allow deaveraged flat customer charges by interexchange carriers, effectively creating a second SLC. There is no basis for finding that the policy is no longer necessary to maintain average rates and protect customers and Congress would not have enacted the mandate if it thought there was no need. The Commission should adopt effective universal service support for interexchange averaging if it allows or requires access charge deaveraging that will further unstabilize incentives to average interexchange rates in accordance with the law.

The Commission should also consider a mechanism that will permit incumbents, particularly small ILECs to recover stranded investment costs associated with the transition to a competitive environment. Specific mechanisms are required to prevent confiscation. Under the prior regulatory regime, the ILECs maintained adequate facilities and invested in state of the art technologies to fulfill carrier of last resort obligations imposed on them by federal and state mandates. Today, the same federal and state authorities that required these investments are promoting a new regime that may result in the ILECs inability to recover prudent investments.

Lastly, the Commission is required to perform a Regulatory Flexibility Act (RFA) Analysis since the rules it adopts will affect more than half of the revenues of small LECs that are "small entities" under applicable the RFA and Small Business Administration regulations.

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COMMENTS OF
THE RURAL TELEPHONE COALITION

The Rural Telephone Coalition (RTC) hereby files its comments in response to the Commission's Notice of Proposed Rulemaking (NPRM) released December 24, 1996, FCC 96-488. The RTC is comprised of the National Rural Telecom Association (NRTA), the National Telephone Cooperative Association (NTCA), and the Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO).

I. ACCESS REFORM IS NEEDED FOR BOTH PRICE CAP AND RATE OF RETURN INCUMBENT LECS.

A. Decisions Regarding Access Reform for Price Cap LECs will Likely Dictate Subsequent Reforms for Rate of Return LECs.

The reforms to the Part 69 access charge structure rules proposed by the NPRM are intended by the Commission to eliminate inefficiencies in those rules and produce a structure that

would be produced by a competitive market.¹ The Commission correctly states that there is a broad consensus in favor of access reform.² Indeed, the RTC has made reference to the necessity of reform, and coordination with other proceedings, several times in recent years.³ Believing that the need for access reform is most immediate for Price Cap regulated LECs because they are likely to face significant competition in the interstate exchange access market from new entrants using unbundled elements, the Commission concludes that it should focus first, with some exceptions, on revising Part 69 only for Price Cap LECs and initiating a separate proceeding for rate of return regulated LECs.

The RTC believes this focus is misplaced and that all aspects of this proceeding must also consider the situation of rate of return LECs. The Commission is probably correct that most of the initial competition through unbundled elements will occur in areas served by the larger LECs. This is to be expected not because they are regulated by price caps, but because they tend to serve the more urban markets with higher densities and lower costs which are attractive to new entrants. This would be the situation if there were no price cap regulation, or all LECs were on price caps. Further, some rate of return LECs can also expect to be subject to providing unbundled elements, and for these the need for relief from a rate structure dictated by the

¹ NPRM, ¶ 13.

² NPRM, ¶ 41.

³ *See, e.g.*, Reply Comments of the National Telephone Cooperative Association to the Notice of Proposed Rulemaking in CC Docket No. 80-286, at 22, 45 (Nov. 9, 1995); Comments of NTCA to the Notice of Inquiry in CC Docket No. 80-286, at 33-35, 66 (Oct. 28, 1994); *see also*, Reply Comments of NTCA to NYNEX Petition for Waiver of Parts 61 and 69 for a Transition Plan to Preserve Universal Service in a Competitive Environment in DA 93-1573, at 4 n.3 (Mar. 2, 1994).

Commission in 1984 is just as urgent⁴. In any event, the need for reform goes well beyond the need to respond to competitors' purchase of unbundled elements. For example, as the NPRM notes, "... the access rules create incentives for IXCs to bypass the LEC switched access network for reasons that have nothing to do with the economics of operating an access network."⁵ Other examples include per minute access charges that exceed the economic cost of providing service to some customers,⁶ and assignment of costs to the wrong elements.

Price cap regulation is not, therefore, a valid indicator of the degree of need of access reform. All incumbent LECs are affected to some degree by the new environment, many aspects of which preceded the 1996 Act. The Commission's statement that rates should reflect the manner in which costs are incurred is no less applicable to rural than to urban LECs.⁷ The real question is how best to achieve that goal.

Even to the extent that the need may be more urgent for some LECs than others, the Commission should not further "atomize" its implementation of the 1996 Act. If the goal is to

⁴ If the Commission prevails before the 8th Circuit, its rules regarding the burden of proof and standards for state decisions on retention of exemption from Section 251(c) will remain in place. These rules are based on the philosophy that exemption is not favored and cannot be maintained where the only harm is that caused by "efficient competitive entry." *In Re Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order* in CC Docket No. 96-98, FCC 96-325, ¶¶ 831-2 (Aug. 8, 1996). Under these rules, which the Commission supports, many rural telephone companies can be expected to have unbundled elements requirements. The Commission cannot logically argue both that the exemption should only rarely be continued and that access reform is not now needed by rural telephone companies because they will be exempt.

⁵ NPRM, ¶ 42.

⁶ NPRM, ¶ 43.

⁷ See NPRM, ¶ 55.

achieve rate structures which reflect the way costs are incurred, then the only logical division is between LECs which incur costs differently in some material way, or between those subject to different degrees of competition. But even if such divisions could be identified, rule making here that deliberately ignored rate of return LECs' circumstances would prejudice and prejudice their later rulemaking because the principles established for one must be consistent with the other. If, however, the Commission purports to defer all rate of return issues for later consideration, it will without doubt reach decisions in the first proceeding, dealing with large LECs, which will then be applied to rural LECs.

B. Continuation of Rate Structure Regulation, A Recent Phenomenon, Is No Longer Justifiable.

For the first fifty years of its existence, the Commission left questions of rate structure design to carrier initiative, subject to tariff review under the just, reasonable and non-discriminatory standards of Section 201(b) and 202(a) of the 1934 Act. The current Part 69 rules had their genesis, as the NPRM notes, in the 1979 ENFIA agreement.⁸ A major issue resolved in that agreement was the responsibility of an interexchange carrier to compensate a LEC for use of its facilities for the origination and termination of interstate traffic. The resolution of that issue involved very specific agreements as to what elements would receive compensation and at what level, and these specifications evolved over a five year period into the Part 69 structure.⁹

From the beginning, it was clear that some Part 69 rate elements simply did not work and had to be granted permanent waivers. Today, the industry is much more complex and changing

⁸ NPRM, ¶ 21.

⁹ See, *In re MTS and WATS Market Structure, Third Report and Order*, 97 F.C.C.2d 682 (1983), *second recon.*, 97 F.C.C.2d 834 (1984).

at a more rapid rate, yet the Commission persists in the view that, in a rule making proceeding, it can prescribe detailed elements which will “reflect the manner in which costs are incurred.”¹⁰

The very discussion in the NPRM of the failings of the current rules in this regard should alert the Commission to the essential impossibility of reasonably approximating this goal. First, for any given LEC at a given point in time, it is very difficult to determine exactly how costs are incurred. Any subdivision of any entity’s costs, whether embedded or forward looking, necessarily requires arbitrary allocations and conventions that, at best, oversimplify complex, dynamic phenomena. Even if a close enough approximation can be developed for that LEC, it is not likely to fit well for other LECs which operate under different market, regulatory and demographic conditions, using technology from different vendors. Further, even assuming reasonable accuracy at the time of closing of the record in a rule making, the facts will certainly change in a much shorter interval than the period between effective revisions of the FCC rules.

The Commission should, therefore, at least begin the process of returning regulation of all LECs to the “carrier initiated rates” methodology contemplated by the 1934 Act, without regard to whether the LECs are price cap or rate of return, or subject to Section 251(c) or not. This is not to say that all immediate steps, as proposed in the NPRM should be deferred. Many of these have merit and general support within the industry.

At the same time, however, the Commission should move toward returning to LECs the initiative to design their own appropriate rate structures, since they are in the best position to understand, and revise as appropriate, a structure which best reflects their circumstances. Such regulatory change would recognize the impossibility of accurately predicting structure issues for

¹⁰ NPRM, ¶ 59.

an entire industry, would be more consistent with the competitive environment, and would make errors the responsibility of the LECs, rather than the Commission. Such a change would not reduce the Commission's authority to set rate levels or to find, in the case of any particular tariff, that the rate structure is inconsistent with the Act.

The RTC proposal, above, is consistent with, but separate from, the NPRM's alternative proposal to use a "market approach" for access reform and inconsistent with the prescriptive approach. For most rate of return carriers the competition they immediately face is not unbundled element competition, but other forms, including that from wireless carriers and bypass by IXC's, and this competition has been developing over many years. The conditions proposed to be imposed on the price cap LECs are therefore unnecessary for rate of return LECs and should not be imposed on them as a cost of moving toward a more rational rate structure.

II. FLAT RATE CARRIER COMMON LINE CHARGES TO IXCS MAKE ECONOMIC SENSE.

As the Commission streamlines regulations and allows markets to work, its suggestion that "it would be preferable for costs related to the loop to be recovered in a manner that is consistent with the manner in which the costs are incurred"¹¹ makes economic sense. The RTC agrees with the latter principle and believes that non-traffic sensitive (NTS) costs associated with the carrier common line (CCL) charge should not be recovered on a traffic sensitive basis. The RTC urges the Commission to bear efficient market principles in mind as it develops cost recovery mechanisms in its proposed structure modifications.

¹¹ NPRM, ¶ 59.

Either a flat rate or bulk billed CCL mechanism will properly reflect cost causation principles. Basing CCL recovery on pre-subscribed lines would work and is the most administratively simple mechanism. A cost recovery system that uses interexchange carriers' (IXCs) percentage of revenue would address the Commission's concern about "dialing-around"¹² the pre-subscribed interexchange carrier (PIC). A flat rate, NTS CCL charge is one proposal that could be "extended to rate-of-return LECs."¹³ However, the proposal to "allow incumbent LECs to collect the flat rate charge that would otherwise be assessed against the PIC directly from any customer"¹⁴ would unnecessarily transfer the collection of costs caused by interexchange service to LECs and their customers. Bulk billing the IXC cost causers and allowing them to pass the cost through to their end users consistent with the section 254(g) prohibition on deaveraged interexchange charges, is the most efficient and justifiable solution.

A. Eliminating The SLC Cap On Additional Lines Will Be Devastating To Rural Economies And Is Unlawful.

The Commission's ill-advised proposal to eliminate or increase the subscriber line charge (SLC) cap on second lines, second residences, and multiline businesses,¹⁵ coupled with the proposed loss of high cost support,¹⁶ would have devastating effects on "access to advanced

¹² NPRM, ¶ 60.

¹³ NPRM, ¶ 61.

¹⁴ NPRM, ¶ 60.

¹⁵ NPRM, ¶ 65.

¹⁶ Federal-State Joint Board on Universal Service, CC Docket No 96-45, *Recommended Decision*, FCC 96J-3 (rel. Nov. 8, 1996) (*Joint Board Recommended Decision*), ¶¶ 90-91.

services,”¹⁷ promotion of second lines, and development of fragile rural economies.

Accordingly, “any changes [the Commission] adopts to the cap on SLCs”¹⁸ should not be

extended to rate-of-return LECs. The Act mandates that “[a]ccess to advanced

telecommunications and information services should be provided to all regions of the nation.”¹⁹

The Commission’s prejudice against second lines will make the cost of additional lines for faxes

or internet access out of reach in rural areas with high costs of service. Rural citizens already

have to travel long distances to reach their schools and libraries. A second line at home makes

the education opportunities available on the internet a realistic possibility for remote rural

citizens. The Commission’s proposal to abandon additional lines, ironically would abandon its

demonstrated commitment to education. Conceivably, a rural subscriber or multiline rural

business customer will have to pay not only the actual cost of the additional lines (due to the

elimination of high cost support), but also an increased SLC. This latest proposal adds insult to

the injury of losing high cost support. Measured by any public interest standard, increased SLCs

on additional lines are clearly detrimental to rural economies.

Additionally, the proposal to increase the SLC cap is inconsistent with Section 254 of the Act. Specifically, the statute mandates that:

consumers in all regions of the nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are

¹⁷ 47 U.S.C. § 254(b)(2).

¹⁸ NPRM, ¶ 65.

¹⁹ 47 U.S.C. § 254(b)(2).

reasonably comparable to rates charged for similar services in urban areas²⁰

The Commission cannot simply ignore the urban/rural comparability commitment of the Act. An increased SLC is the antithesis of comparable access to “interexchange services”.²¹ Small rural businesses and rural subscribers desiring a connection to the information age might not be able to afford additional lines. Also, they will be paying more or an unfair share of the costs for interconnection to the interexchange network. The only entities that will benefit from such a skewed system will be the IXC’s that will garner toll charges without having to pay their share of the costs involved in accessing the local network.

B. The RTC Supports Flat Charges For The NTS Portion of Local Switching Costs, Provided The Actual Costs Are Properly Identified.

The RTC agrees with the Commission that “[a] significant portion of local switching costs, however, likely do not vary with usage.”²² Therefore, “it is more reasonable and economically efficient to recover dedicated line card costs through flat charges.”²³ The Commission’s emphasis on cost causation principles²⁴ is also important.

Ameritech reports that “more than 40 percent of switching costs are NTS.”²⁵ Over the life of a switch, software upgrades can account for the vast portion of the cost of the switch.

²⁰ 47 U.S.C. § 254(b)(3).

²¹ *Id.*

²² NPRM, ¶ 72.

²³ *Id.*

²⁴ NPRM, ¶ 73.

²⁵ *Id.*

Most of NTS software upgrades are necessitated by the demands of the interexchange network. For example, most local rural exchanges could be served by a private branch exchange (PBX). It is the toll network that demands an advanced digital switch. Also, mandates such as number portability increase the NTS costs of a switch.

Rural switching costs are higher per minute or per line than urban switching costs. This is due to small carriers' lack of economies of scope and scale, as well as the lower density of rural areas. The rationale for dial equipment minutes (DEM) weighting is based on this fact. Usage-sensitive costs, such as costs allocated by DEM weighting, still need to be recovered. While DEM weighting is a small cost recovery figure in the scheme of access charges, it represents a substantial amount of necessary support for small, rural LECs with demonstrably higher switching costs. Accordingly, the RTC agrees with the Commission's statement that there are usage-based costs that need to be recovered. Minutes of use charges will still be applicable in any new access charge regime and can be recovered with an explicit, flat rate, bulk billed mechanism. The RTC urges the Commission to consider the inherently higher switching costs (per unit) in rural areas when it examines both traffic sensitive and NTS costs in its rate-of-return proceeding.

C. Transport Costs Should Be Properly Identified And Shifted To The Correct Elements.

The Commission seeks "comment on phasing out the TIC."²⁶ The RTC urges the Commission to carefully examine the nature of the costs that are contained within the transport interconnection charge (TIC). There is no basis in law or logic for the conclusion that the TIC

²⁶ NPRM, ¶ 84.

can be phased out without considering the actual costs of transport. These costs of transport are especially important in remote, rural areas where the cost can be substantially higher. They are real costs, even if they may not all be allocated to the optimal access arrangement. The TIC is a legitimate revenue stream necessary for the provision of access and universal service by small, rural telephone companies. The Commission must fully examine and allocate the 80 percent of transport costs that are contained within the TIC and the 20 percent contained in other rate elements rather than simply phasing out all or part of the TIC.

Fortunately, the Commission is not planning to eliminate the TIC without inspecting the costs. In keeping with cost causation principles, the FCC proposes to “reassign costs included in the TIC to those rate elements to which they are related, including the different transport rate elements.”²⁷ The RTC believes that, for NECA pool members, most of these costs can be isolated and identified. Obviously, due to inherent design differences between urban and rural networks, NECA pool member companies will have different transport costs than price cap companies.

Also, the RTC believes the Commission should examine the original methodology that was used to calculate the initial tandem-switched transport rates. The RTC is in general agreement “that the number of actual minutes traversing tandem circuits is significantly below 9000 minutes per month.”²⁸ Transmission minutes are substantially lower in rural areas. In any case, the Commission needs to use figures that are representative of NECA pool members when it revises its rules and applies them to rate-of-return companies.

²⁷ NPRM, ¶ 92.

²⁸ NPRM, ¶ 94.

The Commission states that its “goal in this proceeding is to establish a mechanism to phase out the TIC in a manner that fosters competition and responds to the court’s remand.”²⁹ The RTC suggests that cost causative principles will enable the Commission to respond to the court. As for a mechanism, transport costs should be included in access since they are a true cost of interconnection to the local network. These costs can be made explicit and bulk billed to the IXCs. The Commission should avoid transferring these costs to any new universal service fund or the end user. As long as the costs are properly identified, they should remain as part of transport rate charges or should be properly shifted to other areas. For example, analog switches require multiplexers to convert the traffic delivered over DS1 trunks to the DS0 level. These costs can be recovered in the local switching charge.

While the Commission is identifying each transport rate element, it must continue to bear in mind the high cost nature of rural areas. As SBC contends, “a study of its interoffice facilities indicates that transport may cost over five times more in low density areas than in high density areas.”³⁰ Since many of these costs are contained in the TIC, the Commission must exercise caution if it phases out any part of the TIC since any adverse revenue impact from doing so will be exacerbated in rural areas. The Commission wisely recognizes this when it states, “some of the costs in the TIC may result from facility-based rates not reflecting the full costs of serving rural low density areas.”³¹ In addressing this rural disparity issue, the Commission seeks “comment on what modifications to our access charge rules for rate-of-return LECs are necessary

²⁹ NPRM, ¶ 98.

³⁰ NPRM, ¶ 107.

³¹ NPRM, ¶ 121.

to address any revisions to the TIC that may be adopted.”³² The RTC suggests that rural LECs be allowed to recover these legitimate costs of providing transport. Phasing out the TIC will not make the costs go away. With rational shifting of costs to their proper elements, while keeping rural dynamics in mind, the Commission can devise a reasonable access mechanism for transport provided by rate-of-return LECs.

III. TRANSITION ISSUES

A. Universal Service

The NPRM proposes to revise Part 69 to reduce interstate costs to reflect any interstate revenues received from the new Universal Service mechanism and requests comment on possible revisions.³³ The present USF, DEM and LTS mechanisms work through the Part 36 separations rules. If the new universal support mechanisms are non-separations based, then Part 36 must be adjusted accordingly. The combination of the new mechanisms and the Part 36 rules must then be tested to ensure that the combined results meet the sufficient and predictable standards of section 254. Unfortunately, the Joint Board’s recommendation does not specify what Part 36 rule changes would be incorporated in adoption of its proposal, and the NPRM notes that the Commission “must determine the extent to which universal support revenues are apportioned to the interstate jurisdiction.”³⁴ The present Part 36 rules provide for an additional expense adjustment for common line cost, and an interstate allocation based on weighted DEM for traffic

³² NPRM, ¶ 122.

³³ NPRM, ¶ 246.

³⁴ NPRM, ¶ 245. The Commission must make clear the separations treatment in its action on the Joint Board’s recommendation.

sensitive costs. Long Term Support (LTS) is interstate revenue which recovers interstate common line cost. If the Commission adopts the proposal to include DEM weighting and LTS in the new universal service mechanism, their character as interstate revenue should not change and the interstate revenue requirement will not change. In contrast, the new USF amounts for recovery of costs must follow the separations treatment ultimately assigned. Support from an interstate expense adjustment of federal universal service mechanism to moderate local and intrastate rates, however, cannot be deducted from interstate costs without becoming unavailable for use in the intrastate jurisdiction for the purpose for which they were intended.

B. Embedded costs

The NPRM recognizes that there is a legitimate argument that incumbent LECs need to recover any difference between their embedded costs and forward looking costs, and asks about the amount of such difference and the reason for the difference, whether the prudence of these historical costs should be determined now and what recovery mechanism should be used.³⁵ In the absence of forward looking cost studies, either by company or through proxies that have been validated for rural telephone companies, neither the RTC nor the Commission can quantify such differences at this time, or state particular reasons beyond those identified in the NPRM. The claims of various IXCs with a vested interest in reduced access charges that inefficiency and overinvestment are a major cause of the difference are simply unfounded. The difference between Hatfield or any other model estimates of investment and actual investment has not been demonstrated by anybody to represent a valid determination of the forward looking cost of any

³⁵ NPRM, ¶¶ 247-270.

LEC or group of LECs.³⁶

Each year since 1983, the IXC's have had the opportunity to challenge the individual or NECA tariff filings of the rural LECs and demonstrate that there is imprudent investment in their rate base. They have not done so, and should not be imagined to make a credible claim simply by repetition, without providing adjudicatory evidence.

If access rates were moved to a forward looking cost basis, the difference between the new definition of cost and the old definition would be a valid revenue requirement to be recovered, including the prescribed rate of return, over a reasonable period of time.

C. The Commission Must Adopt A Mechanism To Permit Small LEC Recovery Of Costs Incurred In Response To A Federal And State Commission-Supervised Regulatory Scheme.

As stated above, the access approach adopted for LECs subject to price cap regulation will necessarily affect the incumbent LECs that are not subject to price caps. The Commission cannot adopt access rules in isolation in this proceeding and wait to separately correct whatever adverse effects these rules will have on small LECs. Even if those rules are not specifically addressed to small LECs, it is likely they will have an indirect or delayed reaction effect on them. The issue of stranded investment is one of the issues that will have a greater adverse effect on small LECs if the Commission proceeds from an erroneous legal or policy position. The Commission should therefore consider how the stranded investment rules it adopts will affect small LECs.

³⁶ See, Reply Comments of U S West, Inc. to *Notice of Proposed Rulemaking*, CC Docket No. 96-45, at 11-14 (May 10, 1996); Comments of RTC to *Public Notice*, DA 96-1087, CC Docket No. 96-45, at 13 (Aug. 2, 1996); Comments of RTC and GVWN, Inc.-Management to *Public Notice*, DA 97-88, CC Docket No. 96-45, at 13-15, 16-21 (Jan. 24, 1997).

Small LECs are dependent on access charges and universal service fund revenues for approximately 65% of their revenues.³⁷ This fact is not a coincidence but the result of federal and state policies that were adopted to enable the delivery of ubiquitous telecommunications service throughout the nation. The principal forces that have shaped industry structure and determined how small LECs recover their interstate costs have been Commission policies and rules and the federal mandates in the Rural Electrification Act as amended to include rural telephone borrowers. Beginning with the adoption of the Joint Board recommendation to establish universal service mechanisms, the Commission has recognized that the high costs of operating in rural areas required rules to ensure that rural telephone companies could expand service and maintain adequate service to existing customers. In *Market Structure (Phase I)*, the Commission noted, "In the context of this proceeding a 'universal service objective' means avoiding actions that would cause a significant number of local exchange service subscribers to cancel that service."³⁸ The former Rural Electrification Administration ("REA" now the Rural Utility Service) also promoted investment in rural areas in furtherance of federal goals and a statutory mandate that required rural telephone borrowers to extend service to rural areas. Specifically, 7 U.S.C. § 922 provides that the RUS must "obtain assurance that the telephone service to be furnished or improved [with RUS loans] will be made available to the widest practical number of rural users." The RUS regulations, 7 C.F.R. § 1735.11, implement this statutory mandate by requiring RUS borrowers to extend telephone service to "all interested potential subscribers in the service area" unless the costs

³⁷ USDA, RUS, 1995 Statistical Report of Rural Telecommunications Borrowers, (1996).

³⁸ 93 F.C.C.2d 241, 266 (1983).

would be exorbitant in particular situations.

The jurisdictional allocations that set the parameters for recovering large portions of nontraffic sensitive and traffic sensitive costs from interstate access charges are dictated by separations rules in Part 36 as well as the access charge rules in Part 69. These rules in turn reflect a goal to preserve a nationwide system “with adequate facilities at reasonable charges.”³⁹ Congress has not abandoned but strengthened that goal by specifying that “quality services should be available at just, reasonable, and affordable rates,” directing that support for universal service be “specific, predictable and sufficient⁴⁰ and adopting a policy committed to rural and urban availability of advanced telecommunications and information services.”⁴¹ Additionally, Congress has given the Commission new authority to order a LEC to provide interstate service to unserved communities.⁴²

Of course, the 1996 Act indicates that Congress intended to promote competition and deregulation through the changes and new laws it adopted. However, there is no indication in the Act that Congress intended Commission rules to ignore past history or the effects of the prior regulatory regime as it enacts rules providing for a transition to the new regime. Indeed, it must be assumed that Congress intended that the Commission would enforce the 1996 Act in a manner that is consistent with fairness, that will be the least disruptive to consumers and the industry and that will comport with the just compensation requirements of the United States Constitution. The

³⁹ 47 U.S.C. § 151.

⁴⁰ 47 U.S.C. § 254(b)(5) and (6).

⁴¹ 47 U.S.C. § 254 (b)(2) and (5).

⁴² 47 U.S.C. § 214 (e) (3).

Commission thus correctly recognizes that it must consider a mechanism to compensate LECs for the stranded investment costs associated with the multiple changes resulting from access charge reform.⁴³ The mechanism that is developed should also provide for recovery of the stranded investment costs associated with the interconnection requirements, separations reform and removal of implicit universal service support. The result from the use of forward looking economic costs is no different, whether applied to access charges or pricing for interconnection and unbundled elements. In either case, incumbent LECs do not recover the embedded costs of facilities deployed under the old regulatory regime. Likewise, to the extent that separations changes shift costs to the intrastate jurisdiction, there must be some mechanism that permits LECs to recover from cost causers embedded costs incurred for interstate service.

A mechanism for recovery is appropriate because Commission policies and rules made pursuant to federal laws have specified the nature and extent of a LEC's duty to provide interstate access. Under Section 214 of the Communications Act, fully subject LECs providing access have been obligated to provide service until the Commission authorized discontinuance. Commission regulations required detailed showing of public need by LECs seeking to extend service by constructing or acquiring facilities.⁴⁴ Also, following the adoption of access charges, Commission dictates required LECs to make the investments required to provide equal access,

⁴³ NPRM, ¶ 248.

⁴⁴ 47 C.F.R. § 63.01-601. The Commission is proposing to forbear from imposing its Section 214 requirements on some carriers but the small LECs that are regulated under rate of return and that it still considers dominant will still be subject to filing requirements. Also, the commission is proposing a longer notification period for discontinuances or reductions in service that involve the small LECs. It proposes a 60 day period for the dominant LEC regulated under rate of return but concludes that a 30 day period should apply to price cap carriers.

800 number portability, calling number delivery, and number portability.⁴⁵

A basic tenet of utility rate making is that the costs associated with providing the facilities to enable these services should be borne by the cost causers. Adherence to this tenet requires a mechanism to prevent the loading of embedded costs onto the captive customers of LECs, whether these customers are purchasers of access or local ratepayers. The Commission has taken the right first step in recognizing that mandated forward looking cost methodologies may result in defining costs below embedded costs by billions of dollars. It must take the next step and recognize that prohibiting recovery of these costs by LECs will result in confiscation. The LECs that invested in plant to fulfill their common carrier obligations and comply with Commission requirements did so under rules that guaranteed they could set their rates to recover prudent investments. Fairness now requires that the Commission adopt measures to compensate the LECs for investments made in reliance on rules that permitted recovery of prudent investments, if it adopts a costing model that is forward looking and necessarily denies recovery of historical costs.

Recently, Chairman Hundt stated that the Commission must address the issue of incumbents' historic costs in its access and universal service proceedings.⁴⁶ The Chairman agreed that a valid argument exists for the recovery of historic or embedded costs and outlined questions

⁴⁵ *In re* MTS and WATS Market Structure and Amendment of Part 69 of the Commission's Rules for Recovery of Equal Access Costs, CC Docket No. 78-72, *Report and Order*, 4 FCC Rcd 2104 (1989). *In re* Telephone Number Portability, *Report and Order and Further Notice of Proposed Rulemaking*, 11 FCC Rcd 8352 (1996). *In re* Provision of Access for 800 Service, *Report and Order*, 4 FCC Rcd 2824 (1989). *In re* Rules and Policies Regarding Calling Number Identification, *Report and Order and Further Notice of Proposed Rulemaking*, 9 FCC Rcd 1764 (1994).

⁴⁶ Speech to Competitive Policy Institute on January 14, 1997.